

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.204: Changes in accounting periods and methods of accounting.
(Also Part I, §§ 446, 481; 1.446-1, 1.481-1, 1.481-4.)

Rev. Proc. 2002-19

SECTION 1. PURPOSE

This revenue procedure modifies Rev. Proc. 97-27, 1997-1 C.B. 680, which provides procedures under which taxpayers may obtain the advance consent of the Commissioner of Internal Revenue to change a method of accounting. In addition, this revenue procedure modifies Rev. Proc. 2002-9, 2002-3 I.R.B. 327, which provides procedures for taxpayers within the scope of that revenue procedure to obtain automatic consent to change a method of accounting.

The changes to Rev. Proc. 97-27 and Rev. Proc. 2002-9 include:

(1) allowing a taxpayer to change its method of accounting prospectively, without audit protection, if the method to be changed is an issue pending for a taxable year under examination or an issue under consideration by either an appeals office or a federal court;

(2) providing that, in the case of changes in method of accounting that result in a negative (*i.e.*, taxpayer-favorable) § 481(a) adjustment, the entire amount of the adjustment will be taken into account in the year of change; and

(3) certain other conforming and clarifying changes.

For a discussion of the policy reasons for certain of the modifications provided by

this revenue procedure, see Announcement 2002-37, 2002-13 I.R.B.

SECTION 2. CHANGES

.01 *Changes to BACKGROUND Sections.* Section 2.01(3) in each of Rev. Proc. 97-27 and Rev. Proc. 2002-9 is deleted.

.02 *Changes to § 481(a) Spread Period for Negative § 481(a) Adjustments.*

(1) Section 5.02(3)(a) of Rev. Proc. 97-27 is modified to read as follows:

“(a) *In general.* Except as otherwise provided in sections 5.02(3)(b) and 7.03 of this revenue procedure, the § 481(a) adjustment period is four taxable years for a net positive adjustment for an accounting method change, and one taxable year for a net negative adjustment for an accounting method change.”

(2) Section 5.04(1) of Rev. Proc. 2002-9 is modified to read as follows:

“(1) *In general.* Except as otherwise provided in section 5.04(3) or the APPENDIX of this revenue procedure, the § 481(a) adjustment period is four taxable years for a net positive adjustment for an accounting method change, and one taxable year for a net negative adjustment for an accounting method change.”

(3) The second sentence in both Example 1 and Example 2 in section 7.02 of Rev. Proc. 97-27 and section 5.04(2) of Rev. Proc. 2002-9 is modified to read as follows:

“The net § 481(a) adjustment for this method change is a positive adjustment of \$30,000 and the adjustment period is four taxable years.”

(4) Section 7.03(1) of Rev. Proc. 97-27 and section 5.04(3)(a) of Rev. Proc. 2002-9 are each modified to read as follows:

“De minimis rule. A taxpayer may elect to use a one-year adjustment period in lieu of the § 481(a) adjustment period otherwise provided by this revenue procedure for positive adjustments if the net § 481(a) adjustment for the change is less than \$25,000. The taxpayer must complete the appropriate line on the Form 3115 to elect this *de minimis* rule.”

(5) Section 4.01(3) of the APPENDIX of Rev. Proc. 2002-9 (relating to the § 481(a) adjustment for certain uniform capitalization methods used by resellers and reseller-producers) is modified to read as follows:

“(3) Section 481(a) adjustment. Beginning with the year of change, a taxpayer changing its method of accounting for costs pursuant to sections 4.01(a)(1)(i), 4.01(1)(a)(iii), or 4.01(1)(a)(iv) of this APPENDIX generally must take any applicable net positive § 481(a) adjustment for such change into account ratably over the same number of taxable years, not to exceed four, that the taxpayer used its former method of accounting. A taxpayer changing its method of accounting for costs pursuant to sections 4.01(1)(a)(ii), 4.01(1)(a)(v), or 4.01(1)(a)(vi) of this APPENDIX generally must take any applicable net positive § adjustment for such change into account ratably over four taxable years. See section 5.04(3) of this revenue procedure for exceptions to this general rule.”

(6) Section 4.01(5) of the APPENDIX of Rev. Proc. 2002-9, which provides an example illustrating the change to and from a UNICAP method of accounting for small resellers and formerly small resellers is modified to read as follows:

“(5) *Example.*

* * *

Because X satisfies the small reseller exception for 1997, X may change voluntarily from the UNICAP method to a permissible non-UNICAP inventory capitalization method under section 4.01 of this APPENDIX. To reflect the removal of the additional § 263A costs from the cost of its 1997 beginning inventory, X must compute a corresponding § 481(a) adjustment, which is a negative \$100,000 (\$1,200,000 - \$1,300,000). The entire amount of this negative § 481(a) adjustment is included in the computation of X’s taxable income for 1997. In addition, X must include \$20,000 of the unamortized 1995 § 481(a) adjustment in 1997 taxable income.

X’s 1997 Ending Inventory:

| | |
|---|------------------------|
| Beginning Inventory (With UNICAP costs) | \$1,300,000 |
| 1997 Increment | 100,000 |
| 1997 § 481(a) Adjustment <Negative> | <u><100,000></u> |
| Total 1997 Ending Inventory | <u>\$1,300,000</u> |

X’s Unamortized 1995 § 481(a) Adjustment:

| | |
|--|-----------------------|
| Unamortized 1995 § 481(a) Adjustment--12/31/96 | \$40,000 |
| Amount Included in 1997 Taxable Income | <u><20,000></u> |
| Unamortized 1995 § 481(a) Adjustment--12/31/97 | <u>\$20,000</u> |

X’s Unamortized 1997 § 481(a) Adjustment:

| | |
|--|----------------|
| 1997 § 481(a) Adjustment <Negative> | \$<100,000> |
| Amount Included in 1997 Taxable Income | <u>100,000</u> |
| Unamortized 1997 § 481(a) Adjustment--12/31/97 | <u>\$ 0</u> |

X also satisfies the small reseller exception for 1998 and, therefore, is not required to return to the UNICAP method for 1998. X, however, must include \$20,000 of the unamortized 1995 positive § 481(a) adjustment in its 1998 taxable income.

X's 1998 Ending Inventory:

| | |
|--|--------------------|
| Beginning Inventory (Without UNICAP costs) | \$1,300,000 |
| 1998 Increment | <u>100,000</u> |
| Total 1998 Ending Inventory | <u>\$1,400,000</u> |

X's Unamortized 1995 § 481(a) Adjustment:

| | |
|--|-----------------------|
| Unamortized 1995 § 481(a) Adjustment--12/31/97 | \$20,000 |
| Amount Included in 1998 Taxable Income | <u><20,000></u> |
| Unamortized 1995 § 481(a) Adjustment--12/31/98 | <u>\$ 0</u> |

In 1999, X fails to satisfy the small reseller exception and, therefore, must return to the UNICAP method as provided under section 4.01 of this APPENDIX. X changes to the simplified resale method without a historic absorption ratio election under § 1.263A-3(d)(3). Assume that X must capitalize \$120,000 of additional § 263A costs to the cost of its 1999 beginning inventory because of this change in inventory method. Because X used a non-UNICAP for two taxable years prior to 1999, the § 481 spread period for the positive § 481(a) adjustment is two years. Therefore, X must include one-half of the § 481(a) adjustment (\$60,000) when computing taxable income

for 1999 and 2000. Assume that X must add \$10,000 of additional § 263A costs to the cost of its 1999 ending inventory because of the \$100,000 increment for 1999.

X's 1999 Ending Inventory:

| | |
|--|--------------------|
| Beginning Inventory (Without UNICAP costs) | \$1,400,000 |
| 1999 Increment | 100,000 |
| Additional § 263A costs in Beginning Inventory | 120,000 |
| Additional § 263A costs in 1999 Increment | <u>10,000</u> |
| Total 1999 Ending Inventory | <u>\$1,630,000</u> |

X's Unamortized 1999 § 481(a) adjustment:

| | |
|--|-------------------|
| 1999 § 481(a) Adjustment | \$120,000 |
| Amount Included in 1999 Taxable Income | < <u>60,000</u> > |
| Unamortized 1999 § 481(a) Adjustment--12/31/99 | <u>\$ 60,000</u> |

Because X fails to satisfy the small reseller exception for 2000, X must continue using the UNICAP method for its inventory costs. Furthermore, X is required to include \$60,000 of the unamortized 1999 positive § 481(a) adjustment in 2000 taxable income. Assume that X is required to add \$10,000 of additional § 263A costs to the cost of its 2000 ending inventory because of the \$100,000 increment for 2000.

X's 2000 Ending Inventory:

| | |
|---|--------------------|
| Beginning Inventory (With UNICAP costs) | \$1,630,000 |
| 2000 Increment | 100,000 |
| Additional § 263A Costs in 2000 Increment | <u>10,000</u> |
| Total 2000 Ending Inventory | <u>\$1,740,000</u> |

X's Unamortized 1999 § 481(a) Adjustment:

| | |
|--|-------------------|
| Unamortized 1999 §481(a) Adjustment--12/31/99 | \$60,000 |
| Amount Included in 2000 Taxable Income | < <u>60,000</u> > |
| Unamortized 1999 § 481(a) Adjustment--12/31/00 | <u>\$ 0 "</u> |

.03 Changes to Scope Restrictions for Taxpayers Under Examination, or Before an Area Appeals Office or a Federal Court.

(1) Taxpayers under examination.

(a) Section 4.02(2) of Rev. Proc. 97-27 (relating to the situations in which Rev. Proc. 97-27 does not apply) is modified to read as follows:

“(2) Under examination. If the taxpayer is under examination, except as provided in sections 6.01(2) (90-day window), 6.01(3) (120-day window), 6.01(4) (director consent), and 6.01(5) (issue pending) of this revenue procedure.”

(b) Section 6.01 of Rev. Proc. 97-27 (relating to procedures for taxpayers under examination) is modified as follows:

“(1) In general. A taxpayer that is under examination may not file a Form 3115 to request a change in accounting method under this revenue procedure except as provided in sections 6.01(2) (90-day window), 6.01(3) (120-day window), 6.01(4) (director consent), and 6.01(5) (issue pending). A taxpayer that files a Form 3115 beyond the time periods provided in the 90-day and 120-day windows will not be granted an extension of time to file under § 301.9100, except in unusual and compelling circumstances.”

* * *

“(5) Issue Pending. (a) A taxpayer that is under examination with respect

to any income tax issue may request to change a method of accounting if the method of accounting to be changed is an issue pending for any taxable year under examination. However, the audit protection provisions of section 9.01 of this revenue procedure do not apply to a taxpayer changing its method of accounting under this section 6.01(5). For this purpose, an issue is pending for taxable years under examination if the Service has given the taxpayer written notification indicating an adjustment is being made or will be proposed with respect to the taxpayer's method of accounting. This notification normally will occur after the Service has gathered information sufficient to determine that an adjustment is appropriate and justified, although the exact amount of the adjustment may not yet be determined.

(b) A taxpayer that requests to change a method of accounting under this section 6.01(5) must provide a copy of the Form 3115 to the examining agent(s) at the same time it files the original Form 3115 with the national office. The Form 3115 must contain the name(s) and telephone number(s) of the examining agent(s). In order to assist in processing an application under this section 6.01(5), the taxpayer should type or legibly write "Issue pending" on the Form 3115."

(c) Section 4.02(1) of Rev. Proc. 2002-9 (relating to situations in which Rev. Proc. 2002-9 does not apply) is modified to read as follows:

"(1) *Under examination.* If, on the date the taxpayer would otherwise file a copy of the application with the national office, the taxpayer is under examination (as

provided in section 3.08 of this revenue procedure), except as provided in sections 6.03(2) (90-day window), 6.03(3) (120-day window), 6.03(4) (director consent), 6.03(5) (changes lacking audit protection), and 6.03(6) (issue pending) of this revenue procedure.”

(d) Section 6.03 of Rev. Proc. 2002-9 (relating to procedures for taxpayers under examination) is modified as follows:

“(1) *In general.* Except as otherwise provided in the APPENDIX of this revenue procedure (see, for example, section 1.01 of the APPENDIX of this revenue procedure), a taxpayer that is under examination may file an application to change a method of accounting under section 6 of this revenue procedure only if the taxpayer is within the provisions of section 6.03(2) (90-day window), 6.03(3) (120-day window), 6.03(4) (director consent), 6.03(5) (changes lacking audit protection), or 6.03(6) (issue pending) of this revenue procedure. A taxpayer that files an application beyond the time periods provided in the 90-day and 120-day windows is not eligible for the automatic extension of time and will not be granted an extension of time to file under § 301.9100, except in unusual and compelling circumstances.”

* * *

“(6) *Issue Pending.* (a) A taxpayer that is under examination with respect to any income tax issue may request to change a method of accounting if the method of accounting to be changed is an issue pending for any taxable year under examination.

However, the audit protection provisions of section 7.01 of this revenue procedure do not apply to a taxpayer changing its method of accounting under this section 6.03(6). For this purpose, an issue is pending for taxable years under examination if the Service has given the taxpayer written notification indicating an adjustment is being made or will be proposed with respect to the taxpayer's method of accounting. This notification normally will occur after the Service has gathered information sufficient to determine that an adjustment is appropriate and justified, although the exact amount of the adjustment may not yet be determined.

(b) A taxpayer that requests to change a method of accounting under this section 6.03(6) must provide a copy of the Form 3115 to the examining agent(s) at the same time it files the original Form 3115 with the national office. The Form 3115 must contain the name(s) and telephone number(s) of the examining agent(s). In order to assist in processing an application under this section 6.03(6), the taxpayer should type or legibly write "Issue pending" on the Form 3115."

(2) Taxpayers before an appeals office.

(a) Section 4.02(3) of Rev. Proc. 97-27 (relating to the situations in which Rev. Proc. 97-27 does not apply) is deleted.

(b) Section 6.02 of Rev. Proc. 97-27 (relating to procedures for taxpayers before an appeals office) is modified as follows:

".02 Taxpayer before an appeals office. A taxpayer otherwise within the

scope of this revenue procedure that is before an appeals office with respect to any income tax issue may request a change in accounting method. However, the audit protection provisions of section 9.01 of this revenue procedure do not apply if the accounting method to be changed is an issue under consideration by the appeals office. A taxpayer that requests to change a method of accounting under this section 6.02 must provide a copy of the Form 3115 to the appeals officer at the time it files the original Form 3115 with the national office. The Form 3115 must contain the name(s) and telephone number(s) of the appeals officer(s). In order to assist in processing an application under this section 6.02, the taxpayer should type or legibly write "Issue under consideration" on the Form 3115."

(c) Section 4.02(2) of Rev. Proc. 2002-9 (relating to situations to which Rev. Proc. 2002-9 does not apply) is deleted.

(d) Section 6.04 of Rev. Proc. 2002-9 (relating to procedures for taxpayers before an appeals office) is modified to read as follows:

".04 Taxpayer before an appeals office. A taxpayer otherwise within the scope of this revenue procedure that is before an appeals office with respect to any income tax issue may request a change in accounting method. However, the audit protection provisions of section 7.01 of this revenue procedure do not apply if the accounting method to be changed is an issue under consideration by the appeals office. A taxpayer that requests to change a method of accounting under this section 6.04 must

provide a copy of the Form 3115 to the appeals officer at the time it files the original Form 3115 with the national office. The Form 3115 must contain the name(s) and telephone number(s) of the appeals officer(s). In order to assist in processing an application under this section 6.04, the taxpayer should type or legibly write "Issue under consideration" on the Form 3115."

(3) *Taxpayers before a federal court.*

(a) Section 4.02(4) of Rev. Proc. 97-27 (relating to the situations in which Rev. Proc. 97-27 does not apply) is deleted.

(b) Section 6.03 of Rev. Proc. 97-27 (relating to procedures for taxpayers before a federal court) is modified to read as follows:

6.03 Taxpayer before a federal court. A taxpayer otherwise within the scope of this revenue procedure that is before a federal court with respect to any income tax issue may request a change in accounting method. However, the audit protection provisions of section 9.01 of this revenue procedure do not apply if the accounting method to be changed is an issue under consideration by the federal court. A taxpayer that requests to change a method of accounting under this section 6.03 must provide a copy of the Form 3115 to the counsel(s) for the government at the time it files the original Form 3115 with the national office. The Form 3115 must contain the name(s) and telephone number(s) of the counsel(s) for the government. In order to assist in processing an application under this section 6.03, the taxpayer should type or

legibly write "Issue under consideration" on the Form 3115."

(c) Section 4.02(3) of Rev. Proc. 2002-9 (relating to situations to which Rev. Proc. 2002-9 does not apply) is deleted.

(d) Section 6.05 of Rev. Proc. 2002-9 (relating to procedures for taxpayers before a federal court) is modified to read as follows:

.05 Taxpayer before a federal court. A taxpayer otherwise within the scope of this revenue procedure that is before a federal court with respect to any income tax issue may request a change in accounting method. However, the audit protection provisions of section 7.01 of this revenue procedure do not apply if the accounting method to be changed is an issue under consideration by the federal court. A taxpayer that requests to change a method of accounting under this section 6.05 must provide a copy of the Form 3115 to the counsel(s) for the government at the time it files the original Form 3115 with the national office. The Form 3115 must contain the name(s) and telephone number(s) of the counsel(s) for the government. In order to assist in processing an application under this section 6.05, the taxpayer should type or legibly write "Issue under consideration" on the Form 3115."

.04 Notional Principal Contracts. Section 14.02 of Rev. Proc. 97-27 (relating to Designated A treatment for changes in method of accounting for notional principal contracts) is deleted.

SECTION 3. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 97-27 and Rev. Proc. 2002-9 are modified and amplified.

SECTION 4. EFFECTIVE DATE

.01 *In General.* Except as otherwise provided in section 4.02 and 4.03 of this revenue procedure, this revenue procedure is effective for taxable years ending on or after December 31, 2001.

.02 *Changes to Scope Restrictions of Rev. Proc. 97-27.* Notwithstanding section 4.01 of this revenue procedure, the changes to the scope restrictions of Rev. Proc. 97-27 provided in section 2.03(1)(a) and (b), 2.03(2)(a) and (b), and 2.03(3)(a) and (b) of this revenue procedure are effective for taxable years ending on or after March 14, 2002.

.03 *Notional Principal Contracts.* Notwithstanding section 4.01 of this revenue procedure, the deletion of section 14.02 of Rev. Proc. 97-27 is effective for Forms 3115 pending with the national office on March 14, 2002.

.04 *Transition Rules.*

(1) *Applications Under Rev. Proc. 2002-9.*

(a) If a taxpayer has filed its federal income tax return on or before April 15, 2002, for a taxable year ending on or after December 31, 2001, and wants to change a method of accounting for such taxable year under Rev. Proc. 2002-9 for an issue pending at examination, or an issue under consideration by an area office or by a federal court, without audit protection, as permitted under this revenue procedure, then

the taxpayer must comply with the requirements of this section 4.04(1)(a). The taxpayer must complete and file a Form 3115 in duplicate. The original must be attached to the taxpayer's amended federal income tax return for the year of change. The amended return must be filed no later than September 10, 2002. A copy of the Form 3115 must be filed with the national office (see section 6.02(6) of Rev. Proc. 2002-9 for the address) no later than when the taxpayer's amended return is filed.

(b) If a taxpayer has applied to change a method of accounting under Rev. Proc. 2002-9 for a taxable year ending on or after December 31, 2001, by filing an application with its federal income tax return on or before April 15, 2002, such change in method of accounting results in a net negative § 481(a) adjustment, and the taxpayer wants to apply the one-year § 481(a) adjustment period of this revenue procedure to the change, then the taxpayer must comply with the requirements of this section 4.04(1)(b). The taxpayer must complete and file a revised Form 3115 in duplicate, reflecting the one-year § 481(a) adjustment period. The original must be attached to the taxpayer's amended federal income tax return for the year of change. The amended return must be filed no later than September 10, 2002. A copy of the revised Form 3115 must be filed with the national office (see section 6.02(6) of Rev. Proc. 2002-9 for the address) no later than when the taxpayer's amended return is filed. Both the original and the copy of the application filed with the national office should be labeled "Substitute Application under Rev. Proc. 2002-19."

(c) If a taxpayer has filed a copy of an application to change a method of accounting under Rev. Proc. 2002-9 for a taxable year ending on or after December 31, 2001, with the national office on or before April 15, 2002, but has not filed its federal income tax return with the original application attached by April 15, 2002, such change in method of accounting results in a net negative § 481(a) adjustment, and the taxpayer wants to apply the one-year § 481(a) adjustment period of this revenue procedure to the change, then the taxpayer must comply with the requirements of this section 4.04(1)(c). The taxpayer must complete and file a revised Form 3115 in duplicate, reflecting the one-year § 481(a) adjustment period. The revised original Form 3115 must be attached to the taxpayer's timely filed federal income tax return for the year of change. The revised copy of the Form 3115 must be filed with the national office (see section 6.02(6) of Rev. Proc. 2002-9 for the address) no later than when the taxpayer's original federal income tax return is filed. The copy of the application filed with the national office should be labeled "Substitute Application under Rev. Proc. 2002-19."

(d) If a taxpayer has filed an original application and/or a copy of an application to change a method of accounting under Rev. Proc. 2002-9 for a taxable year ending on or after December 31, 2001, with the national office on or before April 15, 2002, such change in method of accounting results in a net negative § 481(a) adjustment, and the taxpayer does not file revised applications under either section 4.04(1)(b) or (c) of this revenue procedure (whichever applies), then the four-year §

481(a) adjustment period of Rev. Proc. 2002-9 (prior to its modification by this revenue procedure) will apply to the change.

(2) *Applications Under Rev. Proc. 97-27.* In the case of an application to change a method of accounting for a taxable year ending on or after December 31, 2001, filed under Rev. Proc. 97-27, and pending with the national office on March 14, 2002, the § 481(a) adjustment period for a net negative § 481(a) adjustment for the change will be one taxable year. In such a case, the national office will require the taxpayer to make appropriate modifications to the application or ruling request to comply with the applicable provisions of this revenue procedure. However, if such a taxpayer does not want a one-year § 481(a) adjustment period to apply, the taxpayer must notify the national office prior to the later of April 30, 2002, or the issuance of the letter ruling granting or denying consent to the change. In such a case, the § 481(a) adjustment period rules of Rev. Proc. 97-27, prior to its modification by this revenue procedure, will apply.

DRAFTING INFORMATION

The principal author of this revenue procedure is Grant D. Anderson of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information concerning this revenue procedure, please contact Mr. Anderson at (202) 622-4970 (not a toll-free call).